

Number: **202019023**
Release Date: 5/8/2020
Index Number: 162.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:ITA:B02
PLR-119428-19

Date:
February 06, 2020

Re:
EIN:

LEGEND:

Taxpayer:

Subsidiary 1:

Subsidiary 2:

Subsidiary 3:

Subsidiary 4:

Year 1:

Year 2:

Year 3:

Year 4:

Year 5:

Year 6:

Date 1:

W:

X:

Y:

Z:

Agreement A:

Agreement B:

Agreement C:

Agreement D:

Agreement E:

Agreement F:

Agreement Z=

Product 1:

Product 2:

aa:

bb:

cc:

dd:

\$x:

Dear _____ :

This responds to a letter dated August 19, 2019, submitted on behalf of Taxpayer¹ requesting a ruling that neither the amendments to section 162(f) by P.L. 115-97 nor the execution of Agreement B, Agreement C, Agreement D, Agreement E, or Agreement F (the “B, C, D, E and F Agreements”) prevents the closing agreement²

¹ Taxpayer is the common parent of an affiliated group of corporations filing a consolidated federal income tax return. This affiliated group includes Subsidiary 1, Subsidiary 2 and Subsidiary 3.

² Subsidiary 1 entered into the closing agreement on its own behalf and as the common parent of an affiliated group of corporations filing a consolidated federal income tax return at the time of the closing agreement. This affiliated group included Subsidiary 4 and Subsidiary 3. Subsidiary 4 was merged into Subsidiary 2 in Year 2.

between Subsidiary 1 (and its then-consolidated group, including Subsidiary 4 and Subsidiary 3) and the Internal Revenue Service (the “Service”), which became effective on Date 1, from applying to Settlement Payments that Subsidiary 2 and Subsidiary 3 make pursuant to Agreement A after December 22, 2017.³

FACTS

Taxpayer represents as follows:

Taxpayer is the parent company of a consolidated group of corporations that includes Subsidiary 1, Subsidiary 2, and Subsidiary 3. Subsidiary 4 is a former subsidiary of Subsidiary 1 that was merged into Subsidiary 2 in Year 2. Taxpayer files a consolidated U.S. federal income tax return each year on behalf of itself and the members of the consolidated group.

In Year 1, Subsidiary 4 and other Ws of Product 1 executed Agreement A with the Xs to resolve claims by the Xs for certain monetary, equitable, and injunctive relief. Agreement A settled and resolved all existing and future claims of the Xs for the recovery of aa and associated damages incurred, or to be incurred, by the Xs. Agreement A requires each W to remit annual payments to the Xs, in perpetuity (the Settlement Payments⁴). The Ws are required to remit a base amount of over \$x (subject to the bb) in aggregate per year, and each W’s share of that amount is computed based on that W’s Product 2 sales volume in the preceding year. Subsidiary 3 subsequently became a party to Agreement A.

Subsidiary 1 and the IRS entered into a closing agreement effective on Date 1. Paragraph (1) of the closing agreement provides:

No portion of the Settlement Payments made in taxable years ending on or prior to the date of this closing agreement constitutes a fine or similar penalty within the meaning of section 162(f) of the Code or a capital expenditure within the meaning of section 263 of the Code; and the Internal Revenue Service will not challenge such treatment in taxable years ending after the date of this closing agreement except to the extent (a) any law enacted after the closing agreement

³ The closing agreement addresses settlement payments made pursuant to both Agreement A and Agreement Z. However, Taxpayer has not requested a ruling with respect to the treatment of settlement payments made pursuant to Agreement Z. Therefore, we do not rule on the treatment of settlement payments made pursuant to Agreement Z. Nevertheless, we quote directly from the closing agreement herein, which references the treatment of settlement payments made pursuant to both Agreement A and Agreement Z.

⁴ This letter ruling addresses only on the treatment of “Settlement Payments” made pursuant to Agreement A. Nevertheless, as noted above, we quote directly from the closing agreement. The closing agreement references both the treatment of settlement payments made pursuant to Agreement A and settlement payments made pursuant to Agreement Z.

date requires different treatment of payments of the same nature and character as the Settlement Payments and does not contain an exception for payments made pursuant to an agreement executed prior to the date of enactment (or any other exception applicable to the Settlement Payments), or (b) any future modification of the terms of any of the five respective Settlement Agreements changes the nature or character of the Settlement Payments.

Paragraph (3) of the closing agreement provides:

All Settlement Payments made in taxable years ending on or prior to the date of this closing agreement are ordinary and necessary expenses incurred in carrying on Subsidiary 1's trade or business under section 162(a) of the Code, and are deductible when paid; and the Internal Revenue Service will not challenge such treatment in taxable years ending after the date of this closing agreement except to the extent (a) any law enacted after the closing agreement date requires different treatment of payments of the same nature and character as the Settlement Payments and does not contain an exception for payments made pursuant to an agreement executed prior to the date of enactment (or any other exception applicable to the Settlement Payments), or (b) any future modification of the terms of any of the five respective Settlement Agreements changes the nature or character of the Settlement Payments.

Agreement A provides for a bb. Under certain specified circumstances, the bb reduces the Settlement Payments that the Ws are required to make to the Xs under Agreement A. The bb can never increase the amount of the Settlement Payments or create any new payment obligations on the part of the Ws. Since Date 1, the Ws and a number of the Xs have resolved certain longstanding disputes regarding how the bb is to be computed and applied. These resolutions have taken three forms:

- (1) Agreement B resolved the disputes surrounding the bb with cc Xs. All but one of the cc Xs executed Agreement B prior to December 22, 2017. One of the Xs, Y, executed Agreement B after December 22, 2017.
- (2) Agreement C was executed in Year 6 with cc Xs to resolve the amount of the bb for Year 4 and Year 5. Agreement D resolved the disputes surrounding the bb with additional Xs, on terms similar to those of Agreement B. dd Xs executed Agreement D after December 22, 2017.
- (3) Agreement E resolved the disputes surrounding the bb with Z under terms different from those of Agreement B and Agreement C. Agreement E was executed in Year 3. Agreement F contains certain factual stipulations related to Agreement E.

The B, C, D, E and F Agreements resolved limited contractual disputes regarding the application of the bb. None of the B, C, D, E and F Agreements required the approval of a court, and no such approval was sought or obtained by the Ws or the Xs.

The Settlement Payments continue to be an obligation of the Ws that stems solely from Agreement A, which was an agreement in effect prior to December 22, 2017. The B, C, D, E and F Agreements serve only to reduce the Settlement Payments payable by Subsidiary 2 and Subsidiary 3 under Agreement A. The B, C, D, E and F Agreements do not: increase the amount of the Settlement Payments required and made under Agreement A; change the nature or character of the Settlement Payments required and made under Agreement A; or create any new payment obligation on the part of the Ws.

LAW

Section 7121(a) provides, in part, that the Secretary is authorized to enter into any agreement in writing with any person relating to the liability of such person in respect to any internal revenue tax for any taxable period.

Section 7121(b) provides, in pertinent part, that if a closing agreement is approved by the Secretary, such agreement shall be final and conclusive, and except upon a showing of fraud or malfeasance, or misrepresentation of a material fact, the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States. Section 301.7121-1(c) of the Income Tax Regulations provides that a closing agreement with respect to a taxable period ending subsequent to the date of the agreement is subject to any change in, or modification of, the law enacted subsequent to the date of the agreement and made applicable to such taxable period, and each closing agreement shall so recite.

Section 162(a) provides that there is allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-1(a) of the regulations provides that deductible business expenses include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business.

Section 13306(a)(1) of P.L. 115-97 amended section 162(f). As amended, section 162(f)(1) provides that, except as provided in other paragraphs of section 162(f), no deduction shall be allowed under section 162(a) for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

Section 162(f)(2)(A) provides in part that in general section 162(f)(1) shall not apply to any amount that (i) the taxpayer establishes (I) constitutes restitution (including remediation of property) for damage or harm which was caused by the violation of any law or the potential violation of any law, or (II) is paid to come into compliance with any law which was violated or otherwise involved in the investigation or inquiry described in section 162(f)(1), and (ii) is identified as restitution or as an amount paid to come into

compliance with such law, as the case may be, in the court order or settlement agreement.

Section 13306(a)(2) of P.L. 115-97 provides that the amendments to section 162(f) made by section 13306(a)(1) of P.L. 115-97 shall apply to amounts paid or incurred on or after December 22, 2017, except that such amendments shall not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception shall not apply to an order or agreement requiring court approval unless the approval was obtained before December 22, 2017.

ANALYSIS

As stated above, paragraph (1) of the closing agreement provides:

No portion of the Settlement Payments made in taxable years ending on or prior to the date of this closing agreement constitutes a fine or similar penalty within the meaning of section 162(f) of the Code or a capital expenditure within the meaning of section 263 of the Code; and the Internal Revenue Service will not challenge such treatment in taxable years ending after the date of this closing agreement except to the extent (a) any law enacted after the closing agreement date requires different treatment of payments of the same nature and character as the Settlement Payments and does not contain an exception for payments made pursuant to an agreement executed prior to the date of enactment (or any other exception applicable to the Settlement Payments), or (b) any future modification of the terms of any of the five respective Settlement Agreements changes the nature or character of the Settlement Payments.

Paragraph (3) of the closing agreement provides:

All Settlement Payments made in taxable years ending on or prior to the date of this closing agreement are ordinary and necessary expenses incurred in carrying on Subsidiary 1's trade or business under section 162(a) of the Code, and are deductible when paid; and the Internal Revenue Service will not challenge such treatment in taxable years ending after the date of this closing agreement except to the extent (a) any law enacted after the closing agreement date requires different treatment of payments of the same nature and character as the Settlement Payments and does not contain an exception for payments made pursuant to an agreement executed prior to the date of enactment (or any other exception applicable to the Settlement Payments), or (b) any future modification of the terms of any of the five respective Settlement Agreements changes the nature or character of the Settlement Payments.

Section 13306(a)(2) of P.L. 115-97 generally provides that the amendments made to section 162(f) by P.L. 115-97 do not apply to amounts paid or incurred under any binding order or agreement entered into before the enactment of P.L. 115-97 (December 22, 2017). The agreement giving rise to Subsidiary 2 and Subsidiary 3's

obligation to make the Settlement Payments is Agreement A, which was entered into prior to December 22, 2017, and Taxpayer represents that no court order was required in respect of Agreement A on or after December 22, 2017. Accordingly, there has been no change in law, as described in paragraphs (1)(a) and (3)(a) of the closing agreement, that would cause the IRS to challenge the treatment of the Settlement Payments made pursuant to Agreement A under the closing agreement.

Further, there has been no modification of Agreement A that changes the nature or character of the Settlement Payments. The B, C, D, E and F Agreements resolve limited contractual disputes regarding the application of the bb, which can only reduce the amount of Subsidiary 2 and Subsidiary 3's Settlement Payments. The B, C, D, E and F Agreements do not modify the terms of Agreement A in a way that changes the nature or character of Subsidiary 2 and Subsidiary 3's Settlement Payments. Accordingly, the B, C, D, E and F Agreements have not modified Agreement A in a manner described in paragraphs (1)(b) and (3)(b) of the closing agreement that would cause the IRS to challenge the treatment of the Settlement Payments made pursuant to Agreement A under the closing agreement.

CONCLUSION

Neither the amendments to section 162(f) by P.L. 115-97 nor the execution of the B, C, D, E and F Agreements prevents the closing agreement between Subsidiary 1 (and its then-consolidated group, including Subsidiary 4 and Subsidiary 3) and the IRS, which became effective on Date 1, from applying to Settlement Payments that Subsidiary 2 and Subsidiary 3 make pursuant to Agreement A after December 22, 2017.

This letter ruling does not modify or amend the closing agreement entered into on Date 1, or address the Settlement Payments made pursuant to Agreement Z.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this ruling must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter to the appropriate operating division director. Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under section 6110 of the Code.

Sincerely,

David B. Silber
Acting Senior Technician Reviewer, Branch 2
(Income Tax & Accounting)

cc: